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INCLUSIVE CROWDFUNDING

Andrew A. Schwartz*

TABLE OF CONTENTS

I. INTRODUCTION.....	661
II. SECURITIES CROWDFUNDING IN GENERAL	663
III. THREE TYPES OF SECURITIES CROWDFUNDING.....	664
A. <i>Retail Crowdfunding</i>	664
B. <i>Accredited Crowdfunding</i>	666
C. <i>Intrastate Crowdfunding</i>	669
IV. THE INCLUSIVE NATURE OF RETAIL CROWDFUNDING.....	671
A. <i>Inclusivity Is Valuable</i>	671
B. <i>Inclusivity Is Essential to Crowdfunding</i>	672
C. <i>Retail Crowdfunding Is the Most Inclusive Type</i>	673
V. CONCLUSION	674

I. INTRODUCTION

Securities “crowdfunding”—the sale of unregistered securities over the internet to large numbers of investors, each of whom contributes only a small amount—is a new concept that comes in at least three types: (1) *retail crowdfunding* under Title III of the federal JOBS Act of 2012 (also known as the CROWDFUND Act); (2) *accredited crowdfunding* under Title II of the JOBS Act, which is legally restricted to accredited investors; and (3) *intrastate crowdfunding* under the law of the many states that have authorized the in-state crowdfunding of securities. Which of these three types—all at the dawn of their existence—holds the most promise?

This author has previously suggested various reasons to believe that retail crowdfunding under the federal CROWDFUND Act will prove effective.¹ Other

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¹ See Andrew A. Schwartz, *The Digital Shareholder*, 100 MINN. L. REV. 609, 614, 658–85 (2015) [hereinafter Schwartz, *Digital Shareholder*] (introducing “a set of five novel methods for addressing uncertainty, information asymmetry, and agency costs in the crowdfunding context”); Andrew A. Schwartz, *The Nonfinancial Returns of Crowdfunding*, 34 REV. BANKING & FIN. L. 565, 565–66 (2015) [hereinafter Schwartz, *Nonfinancial Returns*] (explaining the nonfinancial benefits associated with crowdfunding, including entertainment and community-building); Andrew A. Schwartz, *Teenage Crowdfunding*, 83 U. CIN. L. REV. 515, 516 (2014) (claiming that youthful entrepreneurs will be especially well positioned to utilize crowdfunding because of their proficiency with the internet); Andrew A. Schwartz, *Crowdfunding Securities*, 88 NOTRE DAME L. REV. 1457, 1488–89 (2013) [hereinafter Schwartz, *Crowdfunding Securities*] (arguing that the crowdfunding of securities, particularly debt, “is poised to usher in an exciting new chapter in the history of

thoughtful commentators, however, expect that accredited investing will “dominate” over retail crowdfunding, even rendering it “superfluous” and “not viable.”² In their view, the lighter regulatory burden and the freedom to raise unlimited funds makes accredited crowdfunding much more attractive to entrepreneurs.³ State legislators, for their part, seem to think intrastate crowdfunding has its place, given that practically all such laws were enacted after the federal CROWDFUND Act.⁴ These intrastate systems have not garnered much interest to date, however.⁵

Without claiming to finally resolve this debate, this Article adds the following point: Retail crowdfunding is the most *inclusive* form of securities crowdfunding, in the sense that everyone is invited regardless of who they are.⁶ Inclusivity is core to the nature of crowdfunding as a distinct form of capital raising. It also holds a special value in terms of law, politics, and economic prosperity. Compared with the other two types, retail crowdfunding is clearly the most inclusive.

Accredited crowdfunding is legally limited to “accredited” (wealthy⁷) investors; the middle class and poor are expressly barred.⁸ Intrastate crowdfunding authorizes in-state companies to solicit in-state investors; entrepreneurs or investors from the other forty-nine states may not lawfully participate. Retail crowdfunding,

capital formation in the United States—one in which entrepreneurs can thrive and everyone can participate”); Andrew A. Schwartz, *Rural Crowdfunding*, 13 U.C. DAVIS BUS. L. J. 283, 284 (2013) (discussing how crowdfunding can help “entrepreneurs to pursue their business ventures in rural areas”); Andrew A. Schwartz, *Keep It Light, Chairman White: SEC Rulemaking Under the CROWDFUND Act*, 66 VAND. L. REV. EN BANC 43, 44–46 (2013) (asserting that a lightly regulated form of securities crowdfunding would work best for entrepreneurs, small-business owners, and public investors).

² Jason W. Parsont, *Crowdfunding: The Real and the Illusory Exemption*, 4 HARV. BUS. L. REV. 281, 284 (2014) [hereinafter Parsont, *Crowdfunding*]; accord Michael B. Dorff, *The Siren Call of Equity Crowdfunding*, 39 J. CORP. L. 493, 517–18 (2014) [hereinafter Dorff, *Siren Call*].

³ Parsont, *Crowdfunding*, *supra* note 2, at 284–85; see also Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1605 (2013); cf. Joan MacLeod Heminway, *How Congress Killed Investment Crowdfunding: A Tale of Political Pressure, Hasty Decisions, and Inexpert Judgments that Begs for a Happy Ending*, 102 KY. L.J. 865, 884–85 (2014) [hereinafter Heminway, *How Congress Killed Investment Crowdfunding*] (suggesting that Title III compliance costs will be higher than the accredited-only alternatives).

⁴ See *infra* text accompanying notes 65–66.

⁵ See *infra* text accompanying note 71–73.

⁶ See Schwartz, *Digital Shareholder*, *supra* note 1, at 619–29 (describing the inclusive vision of retail crowdfunding).

⁷ Federal law and SEC regulations dating from the early 1980s defined “accredited investor” to include individuals with a net worth of \$1 million. Thompson & Langevoort, *supra* note 3, at 1611.

⁸ To be fair, there is a reasonable rationale for this exclusion: Wealthy people can, by definition, withstand an investment loss that would cause devastating financial harm to a person of modest means. Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1064 (2009) [hereinafter Langevoort, *The SEC*].

by contrast, will be inclusive and open to all Americans, rich and poor, young and old, from coast to coast. This inclusive nature of retail crowdfunding provides an advantage that the other forms necessarily lack.⁹

This Article proceeds as follows: Part II gives a brief introduction to the field of securities crowdfunding. Part III then delves more deeply into the three different types: retail, accredited, and intrastate. Finally, Part IV contends that, because inclusivity is important to crowdfunding (and otherwise), retail crowdfunding holds an underappreciated advantage over the other two forms. A short conclusion recounts the argument.

II. SECURITIES CROWDFUNDING IN GENERAL

Securities crowdfunding is a new idea that builds off of the earlier concept of reward crowdfunding.¹⁰ In reward crowdfunding, financial backers of a project receive its fruits, such as a book, CD, or video game. Websites such as Kickstarter have practiced reward crowdfunding for the past five years, during which time it has quickly grown into a multibillion-dollar market.¹¹

Securities crowdfunding takes the concept one step further by providing backers with a security, such as a share of stock, without registering the securities with the authorities.¹² Selling securities in this way does not violate the federal securities laws (which generally mandate that one register securities with the SEC before offering them to the public) because legal “exemptions” have been put into place: Retail crowdfunding is exempt under Title III of the new JOBS Act,¹³ accredited crowdfunding is exempt under Title II of the JOBS Act,¹⁴ and intrastate crowdfunding is exempt under the longstanding intrastate exemption.¹⁵ The next Part describes these three types in more detail.

⁹ This need not be an exclusive choice; a single company may potentially use multiple methods.

¹⁰ See Schwartz, *Digital Shareholder*, *supra* note 1, at 614–15 (stating that securities crowdfunding takes the idea of reward crowdfunding “one step further”). See generally Schwartz, *Crowdfunding Securities*, *supra* note 1, at 1458–60 (explaining that securities crowdfunding is an idea modeled on the concept of reward crowdfunding).

¹¹ See *Kickstarter Stats*, KICKSTARTER, <https://www.kickstarter.com/help/stats> [<https://perma.cc/L6EA-BMBL>] (last updated Apr. 5, 2016, 8:24 PM) (reporting that 10 million backers have contributed a total of \$2.2 billion to Kickstarter projects).

¹² See, e.g., Joan MacLeod Heminway, *Investor and Market Protection in the Crowdfunding Era: Disclosing to and for the “Crowd,”* 38 VT. L. REV. 827, 829 (2014) [hereinafter Heminway, *Investor and Market Protection*] (defining “securities crowdfunding” as “an offering of securities made over the internet to a broad-based, unstructured group of investors”); Schwartz, *Crowdfunding Securities*, *supra* note 1, at 1458 (defining “securities crowdfunding” as “the sale of unregistered securities over the internet to large numbers of retail investors, each of whom only invests a small dollar amount”).

¹³ See 15 U.S.C. § 77d(a)(6) (2012).

¹⁴ See *id.* § 77d(b)(1).

¹⁵ *Id.* § 77c(a)(11); 17 C.F.R. § 230.147 (2014). But see ME. REV. STAT. ANN. tit. 32, § 16304(6-A)(D) (2014) (invoking exemption based on Rule 504 of Regulation D).

III. THREE TYPES OF SECURITIES CROWDFUNDING

There are at least three distinct types of securities crowdfunding: retail crowdfunding, accredited crowdfunding, and intrastate crowdfunding.¹⁶ This Part will briefly describe each of these three types and the distinctions between them.¹⁷

A. Retail Crowdfunding

Retail crowdfunding was authorized by Title III of the federal JOBS Act, also known as the CROWDFUND Act.¹⁸ This is the best known and most carefully studied form of securities crowdfunding (even though it has yet to go into effect).¹⁹

¹⁶ A potential fourth type of crowdfunding would be based on Title IV of the JOBS Act, which amended Regulation A into what is sometimes referred to as “Regulation A+.” See Rutherford B. Campbell, Jr., *The New Regulation of Small Business Capital Formation: The Impact—If Any—of the Jobs Act*, 102 KY. L.J. 815, 839–47 (2014) (discussing Title IV and the amendments to Regulation A). Although some view Regulation A+ as a type of crowdfunding, Jonathan Zonis and Jason W. Parsont state that this is a complex law that may be best thought of as a hybrid between crowdfunding and an ordinary IPO. *The U.S. Menu of Early-Stage Capital-Raising Options: Lessons for the European Commission*, CLS BLUE SKY BLOG, June 22, 2015, <http://clsbluesky.law.columbia.edu/2015/06/22/the-u-s-menu-of-early-stage-capital-raising-options-lessons-for-the-european-commission> [<https://perma.cc/U932-MMT3>] (“Regulation A may also provide a better forum for ‘crowdfunding’ than the proposed crowdfunding regulation given that it permits access to all investors and also permits widespread general solicitation and advertising with few constraints.”). A company seeking to use Regulation A+ must file an elaborate disclosure document (including, for instance, “management discussion and analysis”) that must be reviewed and approved by the SEC (and state securities regulators, depending on the type of offering), and if the company grows to sufficient size, it would be forced to register as a public company. Thomas J. Kim, *Regulation A+ Takes Effect*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 20, 2015), <http://corpgov.law.harvard.edu/2015/06/20/regulation-a-takes-effect> [<https://perma.cc/B5EP-9QSQ>]. Hence, although Regulation A+ holds significant potential for capital formation, Zonis and Parsont, *supra*, the present discussion will focus on the three forms that are closest to the core of the crowdfunding concept. See Anna Pinedo, *It’s Not Crowdfunding!*, MOFO JUMPSTARTER (July 13, 2015), <http://www.mofojumpstarter.com/2015/07/13/its-not-crowdfunding> [<https://perma.cc/XB5Y-QUSX>] (arguing that Regulation A+ should not be classified as a type of crowdfunding).

¹⁷ For a more complete discussion of each, see Parsont, *Crowdfunding*, *supra* note 2 (describing accredited crowdfunding); Matthew A. Pei, *Intrastate Crowdfunding*, 2014 COLUM. BUS. L. REV. 854, 854 (describing intrastate crowdfunding); Schwartz, *Crowdfunding Securities*, *supra* note 1 (describing retail crowdfunding).

¹⁸ The terms “Title III” and “CROWDFUND Act” are used interchangeably herein.

¹⁹ Parsont, *Crowdfunding*, *supra* note 2, at 300 (citation omitted) (suggesting that retail crowdfunding has received “disproportionate attention” compared with accredited crowdfunding). Pursuant to the SEC’s final regulations, released while this Article was in production, Title III crowdfunding will commence in May 2016.

Title III amends the Securities Act to add a new exemption²⁰ for the crowdfunding of securities, including common stock, preferred stock, bonds, or any sort of investment contract.²¹ There are, of course, a number of limits and rules,²² including the following:

Companies seeking funds through retail crowdfunding²³ must provide some basic disclosures to the public, including (a) the name, address, and website of the company; (b) the names of directors, officers, and substantial investors; (c) a description of the business and the anticipated business plan; and (d) a description of the issuer's financial condition.²⁴ Issuers must also provide a description of the purpose and intended use of the proceeds, the target offering amount,²⁵ the price of the securities to be offered, and a description of the ownership and capital structure of the issuer.²⁶ Following a crowdfunding round, an issuer must annually file with the SEC, and make available to investors, financial statements and a report on the results of operations.²⁷ Companies may not raise more than \$1 million annually;²⁸ investors may invest only up to 5% of their income or net worth each year;²⁹ transactions must be conducted through a "funding portal";³⁰ companies may not

²⁰ An exemption from the ordinary registration requirement. *See* 15 U.S.C. §§ 77e, 77t, 77h-1 (2012).

²¹ *Id.* § 77d(a)(6); *see generally* SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946) (“[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.”). This author has opined that debt may be a particularly attractive type of security to crowdfund. Schwartz, *Crowdfunding Securities*, *supra* note 1, at 1482–89.

²² For a more complete discussion, *see* Schwartz, *Crowdfunding Securities*, *supra* note 1, at 1460–66.

²³ Almost any domestic company may legally engage in retail crowdfunding. The exceptions are publicly traded companies, investment companies, and foreign companies, all of which are prohibited from employing the crowdfunding exemption. 15 U.S.C. § 77d-1(f)(1) (2012).

²⁴ *Id.* § 77d-1(b)(1). The disclosure requirements concerning the financial condition of the issuer vary depending on the size of the offering. Offerings under \$100,000 or less must provide income tax returns for the last fiscal year and unaudited financial statements certified as accurate by the principle executive officer. For offerings between \$100,000 and \$500,000, financial statements reviewed by an independent public accountant are required. For offerings between \$500,000 and the maximum of \$1 million, audited financial statements are required. *Id.* § 77d-1(b)(1)(D)(i)–(iii).

²⁵ Issuers must also announce the deadline to reach their target amount as well as regular updates regarding the progress of the issuer meeting its target amount. If the issuer fails to reach the goal, the whole transaction is cancelled. *Id.* § 77d-1(a)(7).

²⁶ *Id.* § 77d-1(b)(1)(E)–(H).

²⁷ *Id.* § 77d-1(b)(4).

²⁸ *Id.* § 77d(a)(6)(A).

²⁹ *Id.* § 77d(a)(6)(B)(i). Wealthy investors can invest up to 10%. *Id.* § 77d(a)(6)(B)(ii).

³⁰ *Id.* § 77d(a)(6)(C). A broker dealer is also fine. *Id.*

advertise to the public;³¹ and investors may cancel a pledge before the deal closes.³² Crowdfunded securities cannot be transferred or sold by investors for one year after the date of purchase, unless being transferred to the issuer, as part of an offering registered by the SEC, or to an accredited investor or family member.³³ Finally, the CROWDFUND Act authorizes civil actions for fraud against issuers, directors and officers.³⁴

Retail crowdfunding has yet to commence, but even so there is already a rich academic literature on the (hypothetical) merits of this new way of selling securities.³⁵ That literature, however, largely focuses on questions of efficiency and efficacy, rather than inclusivity.³⁶ This may be due, in part, to the fact that inclusivity is such an integral part of retail crowdfunding that commentators do not see a need to make the point.³⁷

B. Accredited Crowdfunding

Although authorized in the same federal statute as retail crowdfunding, accredited crowdfunding under Title II of the JOBS Act is quite distinct from retail crowdfunding under Title III of that Act. Whereas retail crowdfunding was created out of whole cloth, accredited crowdfunding builds off of the longstanding private placement exemption found in Section 4(2) of the Securities Act, as well as Regulation D and Rule 506 thereunder, which date from the early 1980s.³⁸

Rule 506 provides a registration exemption for private offerings made exclusively to “accredited” (wealthy) investors.³⁹ Over time, Rule 506 offerings

³¹ *Id.* § 77d-1(b)(2).

³² *Id.* § 77d-1(a)(7).

³³ *Id.* § 77d-1(e).

³⁴ *Id.* § 77d-1(c)(1)(A), (3). All in all, the regulatory burden imposed by Title III appears to be significant. Thompson & Langevoort, *supra* note 3, at 1605 (asserting that Title III imposes “a quite heavy and costly set of responsibilities on both issuers and any intermediaries that assist them”). The red tape does not appear to be insurmountable, however. *See generally* Schwartz, *Digital Shareholder*, *supra* note 1, at 610–14 (expressing optimism regarding the prospects of retail crowdfunding).

³⁵ *See, e.g.*, C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 1–2; Stuart R. Cohn, *The New Crowdfunding Registration Exemption: Good Idea, Bad Execution*, 64 FLA. L. REV. 1433, 1433 (2012); Heminway, *How Congress Killed Investment Crowdfunding*, *supra* note 3, at 865; Schwartz, *Crowdfunding Securities*, *supra* note 1, at 1457; Robert H. Steinhoff, *The Next British Invasion Is Securities Crowdfunding: How Issuing Non-Registered Securities Through the Crowd Can Succeed in the United States*, 86 U. COLO. L. REV. 661, 661 (2015).

³⁶ *See, e.g.*, Schwartz, *Digital Shareholder*, *supra* note 1, at 613 (explaining that the motivating question for the article is “whether crowdfunding can respond to [the] three fundamental problems [of entrepreneurial finance] in an efficient way”).

³⁷ *But see infra* Part IV.B (discussing inclusivity and its importance to retail crowdfunding).

³⁸ *See* 15 U.S.C. § 77d(a)(2) (2012); 17 C.F.R. § 230.506 (2014).

³⁹ *See* 15 U.S.C. § 77d(a)(5) (2012). An SEC regulation adopted in 1982 clarified that

have become an important source of business capital in the United States.⁴⁰ For years, offerings under Rule 506 could be made only to accredited investors with a preexisting relationship with the company (or its agent).⁴¹ Public advertising or “general solicitation” was specifically prohibited by Rule 506.⁴²

In a significant change,⁴³ Title II of the JOBS Act eliminated the prohibition against advertising and general solicitation in Rule 506, so long as all of the purchasers of the securities are accredited investors.⁴⁴ This change (which was put into effect by the SEC in 2013), combined with the power of the internet, has allowed for an accredited-only form of crowdfunding to quickly develop on websites like AngelList and CircleUp, which are currently operating and available to accredited investors nationwide.⁴⁵

wealthy people—those with a net worth of more than \$1 million—qualified as “accredited” investors and, as such, were endowed with special investing privileges. See 17 C.F.R. §§ 230.501(a)(5), .215(f) (2014); Usha Rodrigues, *Securities Law’s Dirty Little Secret*, 81 FORDHAM L. REV. 3389, 3390–91 (2013) (“The dirty little secret of U.S. securities law is that the rich not only have more money—they also have access to types of wealth-generating investments not available, by law, to the average investor. An investor with enough income or a high enough net worth (an accredited investor) can invest in a private equity fund, for example, or in still-private companies before they go public. The rest of us cannot.”). The theory is that wealthy investors do not need all the legal protections that ordinarily go along with securities offerings because their wealth gives them the “ability to absorb losses.” Langevoort, *The SEC*, *supra* note 8, at 1064 (2009).

⁴⁰ Regulation D is “the dominant offering method in terms of aggregate capital raised in the U.S.,” and Rule 506 is far and away the most popular component of Regulation D. VLAD IVANOV & SCOTT BAUGUESS, *CAPITAL RAISING IN THE U.S.: THE SIGNIFICANCE OF UNREGISTERED OFFERINGS USING THE REGULATION D EXEMPTION 3* (Feb. 2012), http://www.sec.gov/info/smallbus/acsec/acsec103111_analysis-reg-d-offering.pdf [<https://perma.cc/Z488-77CT>].

⁴¹ See Jennifer J. Johnson, *Private Placements: A Regulatory Black Hole*, 35 DEL. J. CORP. L. 151, 169 n.112 (2010) (noting that Rule 506 offerings had (at the time) to be limited “to those investors with whom the issuer or its selling agent has a preexisting relationship”).

⁴² 17 C.F.R. § 230.502(c) (2014) (noting “neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising”).

⁴³ See Christine Hurt, *Pricing Disintermediation: Crowdfunding and Online Auction IPOs*, 2015 U. ILL. L. REV. 217, 249 (noting “general solicitation for private placements could be a sea change for capital raising outside of the IPO”).

⁴⁴ Jumpstart Our Business Startups Act, H.R. 3606, 112th Cong. § 201 (2d Sess. 2012). The issuer must also “take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission.” *Id.* § 201(a)(1).

⁴⁵ See Darian Ibrahim, *Equity Crowdfunding: A Market for Lemons?*, 100 MINN. L. REV. 561, 577 (2015) (“Several Title II sites have come into existence since the JOBS Act was passed. By any measure, including funds raised by these sites for their own operations and startups using these sites to successfully raise funds, these Title II sites are off to a promising start.”).

Accredited crowdfunding arguably holds several significant advantages over retail crowdfunding, primarily because Rule 506, being designed exclusively for accredited investors who can “fend for themselves,”⁴⁶ is free of the limits and obligations Congress adopted in Title III.⁴⁷ While retail crowdfunding limits companies to raising just \$1 million per year, accredited crowdfunding has no limit on the amount a company can raise.⁴⁸ Similarly, retail crowdfunding imposes a cap on the amount each investor can contribute, but accredited crowdfunding has no such cap.⁴⁹ Retail crowdfunding mandates certain specific disclosures, both at the time of the offering and annually thereafter; accredited crowdfunding has no analogous disclosure requirement.⁵⁰

Given all of these advantages of Title II compared with Title III, commentators have questioned why anyone would ever use retail crowdfunding when accredited crowdfunding is available.⁵¹ One observer has predicted that “accredited crowdfunding is likely to dominate and . . . could render retail crowdfunding superfluous”⁵² Professor Michael Dorff agrees: “Given all the advantages accredited crowdfunding has over retail, issuers would be foolish to use the retail exemption if they were also able to attract the interest of accredited investors”⁵³ And Professors Robert Thompson and Donald Langevoort concur as well, saying “it is difficult for us to see why a rational start-up entrepreneur would find it appealing to use [retail crowdfunding] at all.”⁵⁴

These critiques are valid, and the advantages of accredited crowdfunding are real, but these scholars miss an important point that will be discussed further in Part IV below: The inclusive nature of retail crowdfunding gives it a special value that accredited crowdfunding necessarily lacks.

⁴⁶ SEC v. Ralston Purina Co., 346 U.S. 119, 124–125 (1953) (“Exemption from the registration requirements of the Securities Act is [appropriate for an] offering to those who are shown to be able to fend for themselves”).

⁴⁷ Parsont, *Crowdfunding*, *supra* note 2, at 281.

⁴⁸ *Id.* at 301.

⁴⁹ *Id.* at 316.

⁵⁰ *Id.* at 319–20. Retail crowdfunding also has stricter antifraud provisions than accredited crowdfunding. *See id.* at 302–03. This may or may not count as an advantage, because investors may prefer to invest in companies subject to the stricter standards for retail crowdfunding.

⁵¹ *E.g.*, *id.* at 284; Dorff, *Siren Call*, *supra* note 2, at 519; Thompson & Langevoort, *supra* note 3, at 1605; *see* Hurt, *supra* note 43, at 250 (noting “the new Rule 506 . . . surely will result in a decrease in interest in crowdfunding”).

⁵² *See* Parsont, *Crowdfunding*, *supra* note 2, at 284.

⁵³ *See* Dorff, *Siren Call*, *supra* note 2, at 519.

⁵⁴ *See* Thompson & Langevoort, *supra* note 3, at 1605. Thompson and Langevoort expect that accredited crowdfunding will even “come to dominate the IPO.” *Id.* at 1619.

C. Intrastate Crowdfunding

Intrastate crowdfunding largely mimics retail crowdfunding,⁵⁵ except it all takes place within a single state.⁵⁶ Acting pursuant to the venerable exemption for purely intrastate offerings,⁵⁷ roughly one-third of states have adopted legislation authorizing securities crowdfunding within their borders, including Colorado,⁵⁸ Georgia,⁵⁹ Massachusetts,⁶⁰ Michigan,⁶¹ Tennessee,⁶² and Texas.⁶³ These intrastate legislative schemes bear a close resemblance to retail crowdfunding, with small tweaks here and there.⁶⁴ The result is that intrastate crowdfunding is largely identical to retail crowdfunding in form and substance.

The primary impetus for intrastate crowdfunding appears to be the delay in finalizing regulations for retail crowdfunding under Title III of the JOBS Act.⁶⁵ That federal law was enacted in 2012, and it directed the SEC to promulgate rules to implement retail crowdfunding Title III by the end of 2012 but, due to competing priorities, the SEC missed the deadline and issued only a preliminary proposal in late 2013.⁶⁶ Frustrated with the SEC's pace, a number of states took it into their own hands to establish intrastate crowdfunding laws modeled on Title III.⁶⁷

Some of these states made substantive changes in an attempt to improve on the Title III exemption but, apart from the intrastate aspect, the systems are quite

⁵⁵ See *supra* Part II.A.

⁵⁶ See generally Pei, *supra* note 17, at 870.

⁵⁷ 15 U.S.C. § 77c(a)(11) (2012).

⁵⁸ COLO. REV. STAT. § 11-51-308.5 (2015).

⁵⁹ GA. COMP. R. & REGS. 590-4-2-.08, et seq. (2012).

⁶⁰ 950 MASS. CODE REGS. 14.402(B)(13)(o) (2015).

⁶¹ MCL § 451.2102A et seq.

⁶² S.B. 1481, 108th Gen. Assemb., Reg. Sess. (Tenn. 2014).

⁶³ TEX. § 139.25. Notably absent from this list are some of the most populous states, including California and New York.

⁶⁴ Pei, *supra* note 17, at 869–86 (comparing state and federal securities crowdfunding and finding them similar).

⁶⁵ *Id.* at 857 (“[A]lthough the SEC released proposed rules for securities-based crowdfunding on October 23, 2013, those rules still have not been finalized. Not waiting on the SEC, a number of states have enacted their own crowdfunding exemptions.”); Russ Iuculano, Letter from North American Securities Administrators Association to National Conference of State Legislatures 2 (Jan. 17 2014), <http://www.nasaa.org/wp-content/uploads/2011/08/NASAA-Letter-to-NCSL-on-State-Crowdfunding-Bills-1-17-14.pdf> [<https://perma.cc/2T2U-T6JA>] (“Due to the SEC’s delay in rule implementation . . . several states have proposed or enacted their own state crowdfunding bills as an alternative.”); Hugh H. Makens, *State Intrastate Crowdfunding*, SW017 ALI-CLE 217 (2015) (“While the world has awaited the coming of [federal] securities crowdfunding, the states have not been idle. In fact, they have been enacting and proposing intrastate crowdfunding laws and rules at an overwhelming rate.”).

⁶⁶ Crowdfunding, 78 Fed. Reg. 66,428 (proposed Nov. 5, 2013).

⁶⁷ Iuculano, *supra* note 65, at 2.

similar.⁶⁸ Most of the distinctions are designed to make the intrastate systems more liberal than the federal version: Some states have higher issuance limits (e.g., \$2 million as opposed to \$1 million under Title III); disclosure rules are generally less onerous; some states have higher limits for investors (e.g., \$10,000 for ordinary investors, unlimited for accredited ones); some states do not require the use of an intermediary; and some states allow direct advertising to potential investors.⁶⁹

Intrastate crowdfunding is operational in a number of states but does not appear likely to play a significant role going forward,⁷⁰ despite the enthusiasm on the part of state legislatures.⁷¹ Local companies seem to have little present interest in utilizing this method of raising capital,⁷² and once Title III goes live and nationwide retail crowdfunding commences, even this low level of participation may wane.⁷³

* * *

This Part discussed the three types of securities crowdfunding. It relayed the conventional wisdom that accredited crowdfunding has the brightest future and that retail crowdfunding and intrastate crowdfunding are destined for the dustbin. The next and final Part argues that this conventional wisdom, while holding much truth, has failed to appreciate that the inclusive nature of retail crowdfunding gives it a special value that the others lack.

⁶⁸ Pei, *supra* note 17, at 869–86.

⁶⁹ *Id.* at 898–905 (comparing intrastate securities crowdfunding with Title III). Not all the changes are liberalizing. For instance, the Wisconsin and Michigan statutes require quarterly reports from crowdfunding companies, while Title III calls only for annual reports. Compare WIS. STAT. ANN. § 551.202(26) (West 2012), and MICH. COMP. LAWS ANN. § 451.2202 (West 2011), with 15 U.S.C. § 77d-1(b)(4) (2012).

⁷⁰ Theodore Weitz & Thomas D. Halket, *State Crowdfunding and the Intrastate Exemption Under Federal Securities Laws—Less Than Meets the Eye?*, 34 REV. BANKING & FIN. L. 521, 564 (2015) (stating that “expectations of the usefulness of state crowdfunding laws [are] largely illusory”).

⁷¹ *Id.* at 563; see, e.g., Tamara Chuang, *Hickenlooper Signs Equity-Crowdfunding Law to Let Anyone Invest Locally*, DENVER POST (Apr. 13, 2015, 6:30 PM), (reporting that an intrastate crowdfunding bill “sped through the [Colorado] legislature, passing in less than seven weeks,” “with no opposition”), http://www.denverpost.com/business/ci_27906349/hicklooper-signs-equity-crowdfunding-law-let-anyone-invest [https://perma.cc/FZ3N-QX9Y].

⁷² Pei, *supra* note 17, at 858 (stating that “so far, the state exemptions have been used only sparingly . . . estimat[ing], only about twenty companies have tried to use the Kansas and Georgia exemptions since their adoption in 2011”).

⁷³ *Cf. id.* at 858 (querying whether intrastate crowdfunding is unpopular because “the state exemptions are superfluous . . . now that the federal rules are almost in effect”). In the end, intrastate crowdfunding legislation can perhaps be seen less as actually creating a new type of securities market and more as sending a message to the SEC to hurry up and finalize the regulations under Title III. *But see id.* (arguing that, “in spite of the impending federal exemption, state-level crowdfunding exemptions can still play a useful role”).

IV. THE INCLUSIVE NATURE OF RETAIL CROWDFUNDING

Inclusivity is a valuable and important aspect of economic institutions, and is the very essence of what makes crowdfunding different from other methods of securities offerings. Of the three types of securities crowdfunding considered above, retail crowdfunding is plainly the most inclusive. This gives retail crowdfunding a distinctive advantage over accredited crowdfunding and intrastate crowdfunding.

A. Inclusivity Is Valuable

Inclusivity is an important value in our society, both for its inherent and its instrumental value.⁷⁴ An inclusive environment, broadly defined as one in which “all people feel valued and respected and have access to the same opportunities,” can generate positive effects.⁷⁵ This is an intuitive idea: It should come as no surprise that people like it when they are included and treated as an equal worthy of respect.⁷⁶ Thus the concept of inclusivity has been a driving force behind many legal reforms over time, from the one-person-one-vote rule of constitutional law⁷⁷ to the increasingly inclusive capacity rules of contract law.⁷⁸

Most importantly for present purposes, economists have persuasively claimed that inclusive economic institutions are vital to achieving a prosperous society.⁷⁹ “Inclusive economic institutions” are those that “allow and encourage participation by the great mass of people in economic activities . . . and that enable individuals to make the choices they wish.”⁸⁰ Such institutions provide “economic opportunities

⁷⁴ *E.g.*, Christine M. Riordan, *Diversity Is Useless Without Inclusivity*, HARV. BUS. REV., June 5, 2014 (reporting on the late-nineteenth-century writings of William James, in which he observed that “human beings possess a fundamental need for inclusion and belonging”).

⁷⁵ *Id.* (referring to research showing that inclusion in business organizations “has the promise of many positive individual and organizational outcomes such as reduced turnover, greater altruism, and team engagement”).

⁷⁶ *Cf.* FREDERICK A. MILLER & JUDITH H. KATZ, THE KALEEL JAMISON CONSULTING GROUP, INC., THE PATH FROM EXCLUSIVE CLUB TO INCLUSIVE ORGANIZATION: A DEVELOPMENTAL PROCESS 2 (2007), <https://articles.extension.org/sites/default/files/the%20Path%20from%20Exclusive%20Club.pdf> [<https://perma.cc/P56T-MC24>] (explaining that inclusion in the workplace occurs “when everyone has a sense of belonging; feels respected, valued and seen for who they are as individuals; and feels a level of supportive energy and commitment from leaders, colleagues and others so that all people—individually and collectively—can do [their] best work”).

⁷⁷ *Reynolds v. Sims*, 377 U.S. 533, 560 (1964) (“[O]ne person’s vote must be counted equally with those of all other voters . . .”).

⁷⁸ *See* Andrew A. Schwartz, *Old Enough to Fight, Old Enough to Swipe: A Critique of the Infancy Rule in the Federal Credit CARD Act*, 2011 UTAH L. REV. 407, 416–20 [hereinafter Schwartz, *Old Enough to Fight*].

⁷⁹ DARON ACEMOGLU & JAMES A. ROBINSON, WHY NATIONS FAIL 75 (2012) (“Inclusive economic institutions foster economic activity, productivity growth, and economic prosperity.”).

⁸⁰ *Id.* at 74; *see also id.* at 3–4 (“Countries such as Great Britain and the United States

not just for the elite but for a broad cross-section of society.”⁸¹ This defines securities crowdfunding to a T, for the very concept is to invite “the great mass of people”—the crowd—to invest in whichever startup companies and small businesses they choose.

B. Inclusivity Is Essential to Crowdfunding

Inclusivity is foundational to securities crowdfunding. The essence of the concept is the creation of an inclusive market where ordinary investors will be able to make investments that have traditionally been the exclusive purview of wealthy and connected investors.⁸²

We can see the importance of this type of inclusivity by the fact that numerous scholarly authorities, as well as the SEC itself, reject the notion that accredited crowdfunding even qualifies as “crowdfunding.”⁸³ In their view, the term “crowdfunding” implies an inclusive form of investing that is open to investors of any level of wealth, and thus a term like “accredited crowdfunding” is a contradiction in terms.⁸⁴ Similarly, one thoughtful commentator expressly excludes intrastate crowdfunding from her definition of the term on the ground that it is exclusive to residents of one state.⁸⁵

became rich because their citizens . . . created a society . . . where the great mass of people could take advantage of economic opportunities.”).

⁸¹ *Id.* at 75.

⁸² Schwartz, *Digital Shareholder*, *supra* note 1, at 619–20 (explaining that a core purpose of crowdfunding is to “democratize the market for financing speculative companies by inviting ordinary people—‘digital shareholders’—to make investments that are currently offered solely to accredited (wealthy) investors”); *accord* COLO. REV. STAT. § 11-51-308.5 (2015) (“The general assembly hereby . . . [d]eclares that . . . crowdfunding . . . will . . . democratize venture capital formation . . .”).

⁸³ Crowdfunding, File No. S7-09-13, at 9 n.12 (proposed Oct. 23, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240, and 249) (excluding Title II activity under revised Rule 506 from the concept, for “crowdfunding is premised on permitting sales of securities to any interested person, not just to investors who meet specific qualifications, such as accredited investors”); Ibrahim, *supra* note 45, at 563 n.11 (“In my estimation, which is consistent with the nomenclature in the JOBS Act, Title II is a step toward crowdfunding but is not actually crowdfunding. Title III, on the other hand, is crowdfunding . . .”); *id.* at 587 (claiming that “Title II [web]sites are not equity crowdfunding at all”); Joan MacLeod Heminway, *Business Lawyering in the Crowdfunding Era*, 3 AM. U. BUS. L. REV. 149, 151 (2014) [hereinafter Heminway, *Business Lawyering*] (arguing that accredited crowdfunding should not be considered a form of crowdfunding); *cf.* Hurt, *supra* note 43, at 250 (observing that accredited crowdfunding “eliminates one important promise of crowdfunding: the democratization of investing”).

⁸⁴ *But see, e.g.,* Parson, *Crowdfunding*, *supra* note 2, at 281 (coining the term “accredited crowdfunding”); Dorff, *Siren Call*, *supra* note 2, at 518.

⁸⁵ Heminway, *Investor and Market Protection*, *supra* note 12, at 829 n.7 (excluding intrastate crowdfunding from author’s definition of crowdfunding); Heminway, *Business Lawyering*, *supra* note 83, at 151.

This all seems clearly correct. One core pillar of securities crowdfunding is the idea of an inclusive system that invites all investors to participate. Inclusivity is essential to crowdfunding and drives the theory underlying the form. For one thing, securities crowdfunding is supposed to benefit from the “wisdom of the crowd,” which works only with an inclusive crowd made up of many different types of people.⁸⁶ For another, securities crowdfunding can provide nonfinancial benefits, such as altruism, community engagement, and political expression,⁸⁷ and these aspects are enhanced by inclusivity.

C. Retail Crowdfunding Is the Most Inclusive Type

Whatever else can be said about it,⁸⁸ retail crowdfunding offers a highly inclusive vision of a securities market where all Americans⁸⁹ are invited to invest in startups and other business ventures.⁹⁰ Retail crowdfunding is the only type of securities crowdfunding where the whole nationwide “crowd” is invited to participate.⁹¹

As President Obama said when he signed the CROWDFUND Act into law, “Because of this bill, start-ups and small business will now have access to a big, new pool of potential investors—namely, the American people. For the first time, ordinary Americans will be able to go online and invest in entrepreneurs that they believe in.”⁹² In other words, a fundamental and express goal of retail crowdfunding is to break down the differential treatment of accredited investors and everyone else.⁹³

⁸⁶ Schwartz, *Digital Shareholder*, *supra* note 1, at 659–63.

⁸⁷ Schwartz, *Nonfinancial Returns*, *supra* note 1, at 573–80.

⁸⁸ *See id.* at 573 n.61 (collecting predictions that crowdfunding investors will lose their money).

⁸⁹ Retail crowdfunding is presumably limited to adults eighteen and older. *See generally* Schwartz, *Old Enough to Fight*, *supra* note 78, at 419 (describing the modern “infancy” rule that children become adults with the capacity to make a legal contract on their eighteenth birthday).

⁹⁰ Schwartz, *Digital Shareholder*, *supra* note 1, at 625–29; *see also* Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 931–32, 961 (2011) (describing retail crowdfunding as an “inclusive capital formation model”).

⁹¹ *Cf.* Schwartz, *Crowdfunding Securities*, *supra* note 1, at 1458 (defining crowdfunding as “the sale of unregistered securities over the internet to large numbers of *retail investors*, each of whom only invests a small dollar amount”) (emphasis added).

⁹² President Barack Obama, *Remarks by the President at JOBS Act Bill Signing*, THE WHITE HOUSE (Apr. 5, 2012, 2:36 PM) <https://www.whitehouse.gov/the-press-office/2012/04/05/remarks-president-jobs-act-bill-signing> [<https://perma.cc/L8DQ-KNQR>].

⁹³ *See* Schwartz, *Crowdfunding Securities*, *supra* note 1 at 1459 (The “second goal” of securities crowdfunding is to “democratize the market for financing startup companies and small businesses and allow investors of modest means to make investments that had previously been offered solely to wealthy, so-called ‘accredited’ investors.”).

In direct contrast stands accredited crowdfunding, which is an extension of the exclusive world of private placements and Rule 506.⁹⁴ That type of financing is limited to wealthy and institutional investors and expressly excludes retail investors; it is the opposite of an inclusive market.⁹⁵ Intrastate crowdfunding is also limited to a small subset of investors, namely residents of a given state; out-of-state investors need not apply. This is an exclusive system, not an inclusive one.

A company that chooses Title III, even with all its costs and burdens, thus shows its support for inclusive economic institutions.⁹⁶ By making that choice it may generate goodwill with its investors—many of whom may also be customers, depending on the type of business. A company that avoids retail crowdfunding and chooses another type may save in regulatory costs, but it might suffer in the court of public opinion. Imagine a Facebook post that says, “Friends, I invite you to invest in my exciting startup company. We have great prospects, and I hope you will grab a piece of the action! (NOTE: This offer is only open to those with a net worth of at least \$1 million.)” It seems likely that many “friends” would take offense by being left out of this exciting opportunity just because they aren’t sufficiently wealthy. And the company’s personality could be indelibly marked as elitist, with unknowable ramifications down the line.⁹⁷ In short, inclusivity has value,⁹⁸ and retail crowdfunding is the most inclusive type of securities crowdfunding.

V. CONCLUSION

In conclusion, retail crowdfunding under Title III of the JOBS Act has a fundamental advantage over accredited crowdfunding and intrastate crowdfunding: the value of inclusivity. What that is worth in a given instance may be difficult to calculate, but it is surely more than zero. This is one reason to expect that retail crowdfunding, once it commences, may prove more successful than many commentators anticipate.⁹⁹

⁹⁴ Ibrahim, *supra* note 45, at 582 (“Title II sites are still acting under the traditional angel model in important respects Title II sites could fairly be described as traditional angel networks that have migrated online”).

⁹⁵ As mandated by the Dodd-Frank Act, the SEC is currently considering changes to the definition of accredited investor. Nova D. Harb et al., *The SEC Considers Updating the Accredited Investor Definition*, INSIGHTS, June 2015, at 10. If, as some suggest, the definition were to be amended to include “financially sophisticated” investors of any level of wealth, *see id.* at 10–11, this would make accredited crowdfunding somewhat more inclusive, although still not as inclusive as retail crowdfunding.

⁹⁶ *See supra* Part IV.A.

⁹⁷ *Cf.* PRETTY WOMAN (Buena Vista Pictures 1990) (depicting a customer snubbed by a saleswoman due to her impoverished appearance who later avenges the insult by spending lavishly at neighboring stores while boycotting the one where she was snubbed).

⁹⁸ *See supra* Part IV.A.

⁹⁹ In many cases it would appear there is no need to make an election among the three types of securities crowdfunding. Depending on the so-called “integration” rules, a company may be able to employ two, or even all three, forms.